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Feature

By Christopher M. Candon, Christopher M. Desiderio and Daniel W. Sklar

When Is Final, Final? Appeals from § 363(m) Findings

Christopher M. Candon
Sheehan Phinney Bass & Green PA
Manchester, N.H., and Boston

Christopher M. Desiderio
Nixon Peabody LLP
New York

Daniel W. Sklar
Nixon Peabody LLP
Manchester, N.H.

Federal policy weighs heavily in favor of protecting the finality of sale orders in bankruptcy:[1] "It has been held that 11 U.S.C. § 363(m) 'reflects the salutary policy of affording finality to judgments approving sales in bankruptcy by protecting good-faith purchasers, the innocent third parties who rely on the finality of bankruptcy judgments.... The finality and reliability of the judicial sales enhance the value of the assets sold in bankruptcy.'"[2] In addition, finality is important because it removes the chance that purchasers will be dragged into endless litigation.[3]

The First and Third Circuits were recently faced with appeals from sale orders that challenged the finality principle. Two critical facts of the cases were similar: (1) The appellants did not seek a stay of sale order; and (2) the purchasers were designated as good-faith purchasers entitled to the protection of § 363(m) of the Bankruptcy Code. Notwithstanding these circumstances, appeals lodged after the closings proceeded in direct contrast to precedent regarding the finality and reliability of bankruptcy court sale orders. Ultimately, both the First and Third Circuits affirmed the sale orders, finding the appeals to be statutorily moot. In doing so, a weakness might have been revealed in the bankruptcy court sale-approval process and in the finality afforded sale orders that could impact the certainty of and value obtained in future § 363 sales.

The First Circuit's Decision

In September 2015, Tempnology LLC (n.k.a. Old Cold LLC) filed for chapter 11 protection.[4] Tempnology, an innovative textile manufacturer, was forced to file for bankruptcy, in part as a result of a long dispute with one of its contract parties, Mission Product Holdings Inc. In the early days of the case, Tempnology established a sales and marketing process for an asset sale under § 363.

Upon the completion of an extensive sales and marketing process, only two bidders attended the auction: Mission and Schleicher & Stebbins Hotels LLC (S&S). S&S was both the pre- and post-petition secured lender to Tempnology and one of its shareholders. By the end of the auction, S&S prevailed as the successful bidder. Mission challenged the sale by arguing that, among other things, the S&S purchase price was inferior to Mission's bid, and the auction process was flawed and unduly influenced by S&S because of its relationship with Tempnology. Mission objected to S&S being found a good-faith purchaser.

In December 2015, after a two-day sale hearing, the bankruptcy court approved the sale, ruling that S&S was a good-faith purchaser entitled to the protections afforded buyers under § 363(m). Prior to the issuance of the sale order, Tempnology alerted the bankruptcy court, Mission and other parties-in-interest that an immediate closing was necessary, or it would be required to seek additional post-petition financing. In light of these facts, among others, the bankruptcy court waived the stay of the effectiveness of the sale order to allow the sale to close without delay. S&S and Tempnology consummated the sale the same day that the sale order was entered.

Ten days after the sale closed, Mission (without obtaining or even seeking a stay of the sale order) appealed to the First Circuit Bankruptcy Appellate Panel (BAP) and challenged the bankruptcy court's good-faith ruling. The BAP affirmed the

1 *Anheuser-Busch Inc. v. Miller (In re Stadium Mgmt. Corp.)*, 895 F.2d 845, 847 (1st Cir. 1990).
2 *Id.* at 847 (citing *Tri-Cran Inc. v. Fallon (In re Tri-Cran Inc.)*, 98 B.R. 609, 617 (Bankr. D. Mass. 1989) (citations omitted)).
3 *Hazelbaker v. Hope Gas Inc. (In re Rare Earth Minerals)*, 445 F.3d 359, 363 (4th Cir. 2006).
4 *Mission Prod. Holdings Inc. v. Old Cold LLC*, 879 F.3d 376 (1st Cir. 2018).

bankruptcy court's decision, so Mission appealed the sale order to the First Circuit. In its appeal of the sale order, Mission argued that § 363(m) should not insulate a sale order from appeal, even absent obtaining a stay in cases where either (1) the "good faith" finding itself is challenged, (2) the aggrieved party is deprived of adequate time to seek a stay, or (3) the absolute priority rule was allegedly violated.[5]

More than two years after the sale closed, the First Circuit rejected Mission's arguments and recognized the importance of the protections provided by § 363(m). The First Circuit found no grounds to overrule the bankruptcy court's findings that S&S was a good-faith purchaser within the meaning of § 363(m).

Although the Bankruptcy Code does not specify what constitutes good faith under § 363(m), "courts have consistently defined the term as one who (1) purchases in good faith; (2) for value; and (3) without knowledge of adverse claims."[6] The good-faith factor looks at the buyer's behavior during the sales process, where good-faith status can be put at risk by "fraud, collusion [among] the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders."[7] Mere allegations of collusion do not suffice without convincing direct evidence.[8] Imperfections in the sales procedure do not render a purchase to be in bad faith.[9]

The First Circuit, addressing each of these items under the clear-error standard, concluded that the bankruptcy court correctly found S&S to be a good-faith purchaser. The First Circuit further found that Mission's due-process arguments were similarly unpersuasive and that it was on notice that Tempnology had to — and was prepared to — close quickly in the event that the sale was approved.

Since S&S was a good-faith purchaser and the sale closed without a stay, the First Circuit dismissed all remaining challenges to the appeal. Notably, the court did single out Mission's "final shot" argument that *Jevic* controlled the outcome of the appeal. Mission had argued that S&S's assumption of Tempnology's liabilities as part of the sale agreement created a "*Jevic* violation." The First Circuit acknowledged certain restrictions imposed by *Jevic* and observed that "distributions that further significant Code-related objectives" were carved out from the *Jevic* ruling. In the end, however, the First Circuit followed its own precedent on mootness and declined to consider the argument: "We need not — and do not — consider this challenge to the propriety of the sale. As we have explained, section 363(m) applies even if the bankruptcy court's approval of the sale was not proper, as long as the bankruptcy court was acting under section 363(b)."[10]

In other words, even if *Jevic* somehow applied and by its retroactive application[11] the bankruptcy court would have decided the matter differently, the First Circuit declined to consider the argument and instead honored finality in the face of a challenge to an unstayed sale order: "Section 363(m) sets forth only two requirements: that there is a good-faith purchaser, and the sale is unstayed. Nothing in *Jevic* appears to add an exception to this statutory text."[12] In concluding as much, the First Circuit affirmed the sale order.

The Third Circuit's Decision

A few months before the First Circuit's decision in *Old Cold*, the Third Circuit analyzed the issue of statutory mootness in *Pursuit Capital Management Fund 1 v. Burtch (In re Pursuit Capital Management LLC)*.[13] In this chapter 7 case, the trustee sought to sell potential avoidance and other claims that the debtor held against its owners and members. Without the resources to pursue the claims himself, the trustee elected to sell the claims to the highest bidder.

After a contentious auction (telephonic and sealed bids), the trustee moved for the approval of the sale of the claims to a creditor group. Not surprisingly, the potential targets of the claims opposed the sale (the "Pursuit parties"). The bankruptcy court approved the sale and found the creditor group to be good-faith purchasers. The Pursuit parties did not seek a stay of the sale order, and the sale closed. Instead, the Pursuit parties appealed to the district court, which dismissed the appeal as statutorily moot under § 363(m).

The creditor group appealed the sale order to the Third Circuit. While the creditor group focused its appeal on the trustee's ability to sell the claims, the Third Circuit turned its attention to mootness: "This case seems at first blush to be about the validity of the sale of legal claims ... but, at this point, it is really about whether such merits issues have been preserved for present review."[14]

Under Third Circuit case law, § 363(m) moots a challenge to a sale if two conditions are satisfied: "(1) the underlying sale or lease was not stayed pending the appeal, and (2) the court, if reversing or modifying the authorization to sell or lease, would be affecting the validity of such a sale or lease."[15] The court noted that the two-part test

Christopher Candon is a shareholder with Sheehan Phinney Bass & Green PA's Bankruptcy, Restructuring and Creditors' Rights Group and chair of the firm's Corporate Department. Christopher Desiderio and Daniel Sklar are members of Nixon Peabody LLP's Bankruptcy and Financial Restructuring Group.

5 In the appeal, Mission argued that the assumption of pre-petition liabilities pursuant to the purchase agreement violated the absolute-priority rule or constituted a "*sub rosa*" plan. After the U.S. Supreme Court ruled in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), Mission sought to expand that ruling to support the notion that a purchaser's assumption of liabilities violated the new Supreme Court precedent. For ABI's coverage of the *Jevic* case (including past *Journal* articles), visit abi.org/abisearch.

6 *In re Cable One CATV*, 169 B.R. 488, 492 (Bankr. D.N.H. 1994) (citing, *inter alia*, *Oakville Dev. Corp. v. FDIC*, 986 F.2d 611, 613 (1st Cir. 1993)).

7 *Cable One*, 169 B.R. at 493 (citing, *inter alia*, *In re Mark Bell Furniture Warehouse*, 992 F.2d 7 (1st Cir. 1993)).

8 *See, e.g., Cable One*, 169 B.R. at 493-94.

9 *Id.* at 494 (citing *Oakville Dev. Corp.*, 986 F.2d at 613).

10 *Old Cold*, 879 F.3d at 388.

11 *Jevic* was decided more than 14 months after the sale closed.

12 *Id.*

13 *Pursuit Capital Mgmt. Fund 1 v. Burtch (In re Pursuit Capital Mgmt. LLC)*, 874 F.3d 124 (3d Cir. 2017).

14 *Id.* at 127.

15 *Id.* at 135 (citing *Krebs Chrysler-Plymouth v. Valley Motors*, 141 F.3d 490, 499 (3d Cir. 1998)).

has "an additional step because we are first required to ask whether the purchaser at the sale 'purchased ... [the] property in good faith.'"[16]

Responding to similar arguments put forth in *Old Cold*, the bankruptcy court disagreed with the Pursuit parties' allegations of collusion and misconduct and found that the parties acted in good faith. The Third Circuit found the Pursuit parties' claims to be conclusory and unpersuasive, and found the bankruptcy court's good-faith finding to be free from clear error.

Having concluded that the sale was conducted in good faith, the Third Circuit turned to the two-part test under § 363(m). Since no stay had been obtained, the only question was whether the reversal or modification of the sale order would affect its validity. The additional validity prong departs significantly from the "*per se*" rule, but less so from the rule followed in *Old Cold*. As explained by the Third Circuit, the "validity prong of our test provides '[a] narrow exception [that] may lie for challenges to the Sale Order that are so divorced from the overall transaction that the challenged provision would have affected none of the considerations on which the purchaser relied.'"[17] In *Pursuit Capital*, this narrow exception did not apply. The Third Circuit ruled that the remedy sought by the Pursuit parties (*i.e.*, a declaration of the legality of the sale) would undermine and affect the validity of the sale. As a result, the Pursuit parties' appeal was deemed moot and the sale order was affirmed.

Analysis

The outcomes in *Old Cold* and *Pursuit Capital* reaffirm the federal policy of finality in sale orders, and parties that seek to challenge a bankruptcy court sale should seek to stay the sale order to preserve appellate rights. However, the issuance of two circuit-level opinions on the subject suggests that the policy will continue to be tested and buyers will never be fully insulated from extensive litigation until the appeal period expires.

In both cases, the bankruptcy court determined that the buyers were good-faith purchasers and approved the sales. The appealing parties did not obtain or even seek a stay of the sale orders. Instead, after the sales closed, appeals were filed challenging, among other things, the "good-faith" findings. In each case, the appeals proceeded for more than two years. In the end, both courts ruled that the appeals were statutorily moot because the good-faith determinations were affirmed — but only after the prevailing parties had spent time, money and effort to confirm longstanding precedent, or overcome conclusory or unpersuasive attacks on the good-faith purchaser determinations.

In the earlier *Pursuit Capital* case, the Third Circuit noted that its test under § 363(m) is the "minority position" and that "the majority of our sister courts have adopted a '*per se*' rule that moots a challenge to a sale under [Section] 363(m) automatically when a stay is not obtained."[18] Before *Old Cold*, the "*per se*" rule had been observed by the First Circuit.[19] Arguably, the strict application of the *per se* rule is the only way to truly protect a good-faith purchaser and insulate the sale from attacks after the closing.

As demonstrated in *Old Cold* and *Pursuit Capital*, an objection to a good-faith purchaser designation means that the sale can be held up in years of costly and strategic litigation. For a sale to close in the face of an effective and unstayed sale order, only to have that sale later subject to appeal, eliminates the finality policy and creates opportunistic litigation. By not enforcing the stay requirement in the manner imposed under the *per se* rule, the protection afforded to a good-faith purchaser by § 363(m) is severely impaired.

Absent finality, in a § 363 sale the price of the debtor's assets might be reduced if the purchaser is not guaranteed ownership of those assets upon the closing of the sale. Specifically, the risk of subsequent and protracted litigation will be factored into the purchase price that bidders are willing to pay for the subject assets. This "chilling" effect on buyers might result in a loss of what is currently the primary reason why potential new buyers are attracted to § 363 auctions in the first place.

Conclusion

Parties seeking to challenge a sale order to a good-faith purchaser are advised to seek a stay or face the reality that the appeal will ultimately be found moot. However, in departing from the *per se* rule, *Old Cold* and *Pursuit Capital* warn buyers to be cognizant that a good-faith purchaser objection in bankruptcy court proceedings might be the beginning of years of litigation — even if the sale order is unstayed and the sale closes prior to any appeal. abi

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16 *Pursuit Capital*, 874 F.3d at 135.
17 *In re Westpoint Stevens Inc.*, 600 F.3d 231, 249 (2d Cir. 2010) (citing *Krebs*, 141 F.3d at 499).
18 *Pursuit Capital*, 874 F.3d at 135, n.17.
19 *See Stadium Mgmt.*, 895 F.2d at 848.